Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation	)))	CC Docket No. 92-135

<u>Comments of John Staurulakis, Inc.</u>

Thomas J. Moorman
General Counsel,
Regulatory and Industry Affairs

John Staurulakis, Inc.
6315 Seabrook Road
Seabrook, Maryland 20706

Date: August 28, 1992

(301) 459-7590

Table of Contents

Summary

JSI submits that the proposals in this proceeding need to be modified in order to assure that the Commission's goals of creating a regulatory environment that presents a "continuum" of choices for a Local Exchange Carrier (LEC), while assuring "revenue neutrality" between and among the options, can be met. In taking any action arising out of this proceeding, the Commission should recognize and affirm the need of the smaller LEC industry to retain regulatory options.

With regard to the Incentive Regulation proposal, JSI believes that if the Commission's goal is to provide a regulatory "continuum" and encourage LECs move to incentive regulation, the current proposal requires modification. Moreover, JSI believes that, while the proposal is certainly geared towards the "mid-size" companies, the Incentive Plan, if modified, may be attractive for small companies as well. JSI generally supports the Commission's proposal to expand the scope of Section 61.39 to include carrier common line and end user subscriber line charges. However, JSI supports the modification of the proposal to permit more flexibility in the areas of new service and end user access tariff filings. Likewise, JSI generally supports the thrust of the Commission's proposal with regard to reducing the regulatory burdens for Baseline Rate of Return Regulation LECs, subject to two modifications. Finally, in the area of mergers and acquisitions, JSI submits the Commission should permit the purchasing LEC the option to retain or change its current regulatory regime.

RECEIVED

AUG 2 8 1992

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation	)))	CC Docket No. 92-135

Comments of John Staurulakis, Inc.

John Staurulakis, Inc. (JSI), by its attorney, hereby submits these comments in response to the Federal Communications Commission (Commission) Notice of Proposed Rulemaking (NPRM) in the above-captioned proceeding.[1] In the NPRM, the Commission requests comment on a number of proposals aimed at establishing a "continuum of increasingly incentive based proposals that permit companies to choose a plan which best fits their circumstances."[2] JSI believes that, subject to the modifications suggested herein, the NPRM's proposals should be adopted as they each will further the public interest.

JSI is a consulting firm specializing in independent telephone company toll settlement and cost consulting services to more than 150 telephone companies in some 30 states. In that capacity, JSI assists in the preparation and filing of several interstate traffic

---

1 See In the Matter of Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation, Notice of Proposed Rulemaking, CC Docket No. 92-135, FCC 92-258, released July 17, 1992.

2 Id. at para. 3. The proposals include an optional incentive plan, expansion of the Commission's current Section 61.39 rules and policies for small companies, revisions to the Commission's current Section 61.38 tariff support rules for Baseline Rate of Return regulation, and incentive regulation and regulatory reform within the existing pools. In addition, the Commission also requests comments on the impacts of mergers and acquisitions under its proposed incentive regulation.

sensitive tariffs under the Commission's current 61.39 rules, as well as a number of interstate end user tariffs under traditional tariff rules including Section 61.38. In light of this experience, JSI believes that the Commission's proposals would be in the public interest subject to certain modifications. Specifically, JSI submits that the proposals need to be modified in order to assure that the Commission's goals of creating a regulatory environment that presents a "continuum" of choices for a Local Exchange Carrier (LEC), while assuring "revenue neutrality" between and among the options, can be met.[3] In support thereof, the following is shown:

I. Optionality Among Regulatory Options is Crucial

The non-Price Cap LEC industry is a wide and diverse group. As the Commission appropriately notes, the "carriers that remain under rate of return represent a diverse group of companies."[4] Many of these LECs face challenges that other portions of the industry do not -- providing quality service over wide and sparsely populated areas. In light of these challenges, JSI believes that no firm set of rules should be imposed upon the LECs as a result of the NPRM. Rather, JSI submits that, in taking any action arising out of this proceeding, the Commission should recognize and affirm the need of the smaller LEC industry to retain regulatory options.

---

3 See id.

4 Id. at para. 2.

II. Incentive Based Regulation

JSI submits that the proposal offered by the Commission for incentive based regulation (the Incentive Plan) could be a viable option for LECs that desire to opt out of rate of return regulation. However, JSI believes that, if the Commission's goal is to provide a regulatory "continuum" and encourage LECs move to incentive regulation, the current proposal requires modification. As described below, JSI submits that certain aspects of the proposal may, in fact, create disincentives for companies to select this alternative. Moreover, JSI believes that, while the proposal is certainly geared towards the "mid-size" companies, the Incentive Plan, if modified, may be attractive for small companies as well.

A. Mid-course Corrections Should Be Permitted

The Commission requests comments on whether LECs choosing the Incentive Plan should be permitted to file mid-course corrections outside of the proposed biennial filings, and whether the Incentive Plan LEC should be required to meet a "heavy burden" in order to have such corrections approved.[5]

JSI submits that, absent the right to file mid-course corrections,[6] an Incentive Plan LEC would not have the means to assure that during the two-year period covered by the tariff

---

[5] See id. at para 10.

[6] JSI notes that the Commission uses the term "mid-term changes" in its discussion. See id. JSI interprets this term to be synonymous with what is currently referred to under Section 61.39 policies as "mid-course" corrections. If this interpretation is incorrect, JSI notes that there appears to be no reason to limit tariff filings by an Incentive Plan LEC in order to assure adequate recovery of its costs.

filing, its rates and return remain reasonable. In JSI's view, the inability to file mid-course corrections creates a major disincentive in the Commission's proposal. First, the proposal set out in the NPRM is new. Absent the flexibility to make mid-course corrections to assure reasonable cost recovery, the uncertainty associated with the Incentive Plan could, by itself, create a disincentive to opt for this regulatory regime. Second, with the deployment of new technology, certain of the expenses may not be within the control of the LECs. As a result, failing the right to file mid-course corrections, the Commission's proposed Incentive Plan may be simply too financially uncertain. Finally, any filing made would still be subject to rigorous Commission and industry review. JSI submits that these procedures should provide a more than adequate check on the reasonableness of mid-course corrections.

JSI also believes that the suggestion that Incentive Plan LECs be required to meet a "heavier" burden to justify mid-course correction rate adjustments is unnecessary. The Commission's current tariff review procedures provide for sufficient review to act upon mid-course corrections; there is no need for requiring additional burdens. JSI is unaware of any experience where the Commission's policy of permitting mid-course corrections is somehow being compromised. Absent such showing, and in light of the Commission's experience to date, a heavier burden of justifying mid-course corrections merely creates an additional risk for LECs choosing the Incentive Plan. Therefore, JSI submits that the

Commission's current procedures do not require modification.

B. <u>The Commission's 100 Basis Points Standard Is Inadequate</u>

As part of the Commission's proposal, LECs opting for the Incentive Plan would be permitted to retain earnings that are 100 basis points above the current authorized Rate of Return.[7] JSI submits that the use of 100 basis points is an inadequate measure of the amount of additional earnings that would be required to make the Incentive Plan appealing. The additional reporting requirements and uncertainty of targeting rates for known and measurable changes, coupled with the changes in technology and market conditions confronting the LEC industry, require an incentive earnings band of at least 200 basis points with no sharing requirements to make the risk associated with the Incentive Plan worth the challenge.[8]

C. <u>The Known and Measurable Changes Standard</u>

JSI agrees with the Commission that LECs which elect the Incentive Plan should be afforded the opportunity to adjust rates for "known and measurable changes" at the time of the LEC's biennial filing.[9] JSI also submits that, while the Commission should provide some guidance as to what constitutes "known and measurable changes,"[10] the standard should remain flexible.

---

7 <u>See</u> <u>id</u>. at para. 12.

8 <u>See</u> <u>generally</u> Proposal of the United States Telephone Association on Small and Midsize Telephone Company Regulatory Reform (March 6, 1992) (USTA Proposal).

9 <u>See</u> NPRM at para. 14.

10 <u>Id</u>.

To this end, JSI supports the suggestion offered by the United States Telephone Association that an Incentive Plan LEC should be permitted to adjust its tariff filing where an objective confirmation of a future event causing the cost or demand change can be shown.[11] JSI believes that, by adopting this statement, the Commission would create a better understanding of its proposal to the LECs which may find the Incentive Plan a viable regulatory alternative.

D. New Service Standard

The Commission states that it "proposes to permit carriers subject to the incentive plan to introduce new services with a presumption of lawfulness if the anticipated earnings are de minimus and do not exceed the rate charged by the geographically closest price cap regulated LEC offering the same or similar service."[12] Failing which, the Incentive Plan LEC would need to make a Section 61.38 showing. These statements, taken literally, appear to contradict the very goal of the Commission to encourage the introduction of new services in a timely manner. Therefore, JSI submits that the Commission should fine-tune or clarify its proposal in order to assure that the introduction of new and innovative services to the public in a timely manner is not thwarted. Specifically, JSI submits that the LECs under the Incentive Plan should have the right to price their services

---

[11] See USTA Proposal at 11-12.

[12] NPRM at 16 (footnote omitted). JSI does not take issue with the 2% of total operating revenue as the standard for establishing the de minimus test. See id.

without regard to comparable Price Cap LEC offerings and should be free to introduce such services without awaiting Price Cap LEC action.

The Commission's proposal could suggest that an Incentive Plan LEC, in deciding whether to offer a service, should disregard its cost of such service where its cost is higher than the closest Price Cap LEC in order to avoid the additional regulatory delay required under the existing Commission's rules.[13] Alternatively, if the Incentive Plan LEC was first to offer the service, it could be forced to go through additional time delays and administrative burdens of Section 61.38 since no comparable service is being offered by a "neighboring Price Cap LEC." In both circumstances, the provision of service to the customer is delayed. In light of these potential anomalies, JSI submits that the Commission should state that, subject to the 2% of total operating income standard, an Incentive Plan LEC can offer a service with the presumption of lawfulness without that service being offered in a Price Cap LEC's territory[14] and without regard to the neighboring Price Cap LEC's price of that service. JSI believes that this clarification would further the Commission's goal of introducing new and innovative services in a timely manner. Moreover, with such clarification,

---

[13] JSI notes that this hypothetical is possible. It is well established that the smaller LECs are typically higher cost companies in light of their less densely populated service areas as compared to the more densely populated BOC urban areas.

[14] JSI notes that the possibility of an Incentive Plan LEC offering a service that is not being offered by the closest Price Cap LEC may create the incentive for that Price Cap LEC to offer the service.

service offerings would still be based on the cost of the provider of that service, not the cost structure of another company.

E. Quality of Service Reports

The Commission proposes that Incentive Plan LECs file quality of service reports on a quarterly basis.[15] For the reasons stated below, JSI believes that this proposal can be modified to require annual quality of service filings without a negative effect on service quality.

JSI questions whether the additional earnings, even with the expansion of the 100 basis points to 200 basis points, creates the incentive to lower service quality in light of the existing safeguards against such a result. The majority of smaller LECs that may be interested in the Incentive Plan operate in smaller communities. Moreover, the management of the LEC usually live within and are members of the communities they serve. This fact alone suggests that any LEC that lowers service standards will hear the complaints directly from the communities they serve. In addition, certain States require the quality of service reports and to impose additional filing requirements could be unduly burdensome.

Therefore, in light of the potential cost of compliance to both the Commission and the Incentive Plan LEC, the limited scope of additional profits, and the fact of community presence and involvement, JSI submits that the service quality reports could be filed annually and that the goals of the Commission to assure

---

[15] See id. at para. 21.

quality service would not be undermined. Moreover, to the extent that service quality problems arose outside the annual filing period, they could be dealt with on a case-by-case basis.

F. Eligibility

JSI believes that the Commission should modify its tentative conclusion regarding the eligibility associated with participation in the Incentive Plan. As indicated in the NPRM, the Commission stated its tentative belief that "companies electing the incentive plan develop and maintain both common line and traffic sensitive rates within the incentive plan rules...."[16] JSI believes that the Commission's desire to encourage LECs to non-rate of return based regulation could be furthered with the additional option that a LEC could opt for the Incentive Plan for its traffic sensitive offerings only.

As indicated above, the Commission has indicated its belief that the "preferred approach to regulatory reform for this segment of the LEC industry is a continuum of increasingly incentive based approaches that permit companies to a plan which best fits their circumstances."[17] If the Commission were to permit non-pooling traffic sensitive LECs the option of incentive regulation, additional efficiencies could be gained and shared by the users of such services in future periods. Further, these incentives could be realized in those cases where the LEC's non-traffic sensitive costs are such that de-pooling for common line services is not a

---

[16] Id. at para 24.

[17] Id. at para. 3.

viable alternative, i.e., high loop cost areas. Therefore, without the optionality suggested by JSI, potential increases in efficiencies may not be realized.

Finally, it bears noting that there is a market check on this flexibility. If an Incentive Plan LEC's charges for its traffic sensitive services are out of line or that LEC fails to meet industry quality standards, the purchasers of such services, the Interexchange Carriers (IXCs), could complain and/or possibly opt for alternatives to the LEC's network. As such, market checks in place of regulation already exist that can supplant the need for regulatory relief.

As a result, JSI submits that the Commission, in light of its stated goal of creating an incentive based "continuum" and the fact that IXCs will respond to any overpricing or poor quality service, should permit LECs the option to go into the Incentive Plan for traffic sensitive services if these are the only services that such LECs offer outside the current pools.

III. Section 61.39 Carriers

As with the Commission's proposal for incentive regulation, JSI generally supports the Commission's proposal to expand the scope of Section 61.39 to include carrier common line and end user subscriber line charges.[18] However, JSI supports the modification of the proposal to permit more flexibility in the areas of end user filings and new service filings.

---

[18] See id. at para. 35.

JSI submits that the Commission should permit LECs to file end user rates under 61.39 but remain within the common line pool and/or traffic sensitive pool.[19] JSI believes that use of the simplified Part 61.39 standards are appropriate for end user access in light of the fact that companies which currently file only end user access tariffs offer such services at rates at or below the Commission's current $3.50 and $6.00 rate levels. Moreover, JSI does not believe that this added optionality would, in any way, compromise the Commission's goals articulated in this proceeding. Quite to the contrary, JSI submits that this optionality would further the Commission's goals of simplification, reduction of regulatory burdens and assurance of reasonable rates.[20]

In addition, JSI submits that the Commission should incorporate the same time periods for approval of new services as it has proposed under the Incentive Plan and for "Baseline Rate of Return LECs."[21] Specifically, the Commission should expand Section 61.39 to include the requirement that new service offerings are prima facie lawful and are approved on 14 days' notice absent Commission action, subject to the requirement that the filing not

---

[19] The option of filing end user access charges while remaining in the common line pool exists today. However, such an end user rate filing would need to comply with the Section 61.38 standards.

[20] While the Commission has requested that comments on enforcement issues be addressed in its proceeding regarding rate of return prescriptions, CC Docket No. 92-133, see id. at para. 12, n. 11, in JSI's experience Section 61.39 has worked well and there is no need to alter the requirements that Section 61.39 need not be subject to earnings monitoring and quarterly reports.

[21] See id. at para. 45.

exceed 2% of total company operating revenue. However, the Commission should modify the standard as suggested in Section II.D, supra, for the reasons stated therein.

In the context of its Baseline Rate of Return proposal, the Commission has tentatively concluded that a streamlined regulatory framework for approval of new services is warranted based on competitive necessity and the need to provide new services and technologies to the communities the LECs serve.[22] Section 61.39 carriers face these same pressures. Moreover, the Commission, itself, has indicated that its experience with Section 61.39 LECs has been positive. "Generally, rates filed by Section 61.39 carriers have been consistently lower than NECA rates. Increases were less than NECA rates; reductions were greater than NECA rate reductions."[23]

Therefore, JSI submits that there appears no reason why the 14 day notice requirement for new services should not apply for Section 61.39 LECs. Not only would this rule permit Section 61.39 LECs to more rapidly respond to a market demand with a new service offering, there would be reduced administrative burden experienced by the Commission and LECs. Further, the IXCs, as purchasers of such services, would act as a market check on the reasonableness of the LECs' rates. As such, JSI submits that the factual and legal predicates have been laid to permit Section 61.39 LECs to make new

---

[22] See id.

[23] Id. at para. 29.

service filings on 14 days' notice.[24] JSI believes that the public interest would be served by a quickened response to the customer for new services, with the additional safeguard of IXC oversight of any LEC filing.

IV. Baseline Rate Of Return Regulation

Again, JSI generally supports the thrust of the Commission's proposal with regard to reducing the regulatory burdens for Baseline Rate of Return Regulation (Baseline ROR) LECs.[25] JSI submits, however, that the proposal be modified in two ways.

First, the Commission, consistent with the positions and for the reasons stated supra, should eliminate the requirements related to neighboring Price Cap LEC services and neighboring Price Cap LEC rates for new service offerings by Baseline ROR LECs.[26] JSI incorporates the reasoning expressed earlier herein by reference.[27]

Second, the Commission should permit Baseline ROR LECs opting under these new rate setting standards to choose either: (1) extrapolations from historical costs and demand for future periods;

---

[24] See id. at para. 30. To this end, JSI supports the suggestion that NECA be required to file a simplified access tariff containing the terms and conditions for the additional carrier common line and end user access services. See id. at para. 36. However, JSI requests that the directive establishing this new tariff specifically include a blanket waiver of Section 61.74 of the Commission's rules regarding the inability to cross-reference other instruments in a tariff filing. See 47 C.F.R. Section 61.74. This clarification could avoid unnecessary confusion for LECs filing under the expanded Section 61.39 rules at the time tariffs are due.

[25] See NPRM at paras. 42-44.

[26] See id. at para. 45.

[27] See Section II.D, supra.

or (2) actual projections of future demand and costs for rate development purposes.[28]

JSI believes that options for these LECs should not be foreclosed if the LEC demonstrates, as it would today, the reasonableness of its future projections regarding demand and cost. With the increased deployment of technologies and services, for example the deployment of SS7 technologies and the continued movement toward a data base environment (e.g., Line Information Data Base and 800), historical experience may not provide an adequate benchmark for future performance. Therefore, JSI believes that the option to choose between historical extrapolations or actual projections should be left to the LEC to decide in the context of its tariff filing for a given service, a decision which ultimately is subject to the Commission's review for reasonableness.

V. Mergers and Acquisitions

Finally, JSI submits these comments on the rules governing the merger or acquisition of telephone companies under the Incentive Plan.[29] JSI submits that the Commission should not require Section 61.39 LECs nor Baseline ROR LECs to convert to the Incentive Plan when such LECs acquire exchanges from an existing Incentive Plan LEC.

Generally, where a smaller LEC is purchasing exchanges from a neighboring LEC, the purchased exchanges fit within the acquiring

---

[28] See id. at para. 44.

[29] See id. at para. 50.

LEC's existing service territory, i.e., the new exchanges have similar communities of interest and/or creates continuous service within the dominion and control of a single LEC. JSI submits that these situations are quite different from concerns of "gaming" the system that led to a contrary conclusion on the same issue in the Price Cap proceeding. Therefore, the Commission should limit additional burdens associated with the purchase of an Incentive Plan LEC's exchange(s) and permit the purchasing LEC the option to retain or change its current regulatory regime.

VI. Conclusion

JSI recognizes the need for the Commission to assure that the regulatory environment for small LECs is conducive to the challenges created in the telecommunications markets they serve. Subject to the modifications suggested herein, especially the need for optionality, JSI believes the proposals should assist this goal and should not only provide the opportunity of greater and more timely service offerings but also should provide the LECs the flexibility to respond to market changes as they arise.

WHEREFORE, JSI requests the Commission adopt the NPRM with the modifications suggested herein.

Respectfully submitted,

John Staurulakis, Inc.

By: Thomas J. Moorman

Thomas J. Moorman
General Counsel,
Regulatory and Industry Affairs

John Staurulakis, Inc.
6315 Seabrook Road
Seabrook, Maryland 20706
(301) 459-7590

Date: August 28, 1992